

Directorate of  
Intelligence

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# Near East and South Asia Review

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Near East and  
South Asia Review

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Page

Articles

Kuwait-Iran: Escalating Tensions

1

Relations between Kuwait and Iran have deteriorated sharply over the past year due to increased Iranian attacks on Kuwait-bound ships and Iranian-sponsored subversion in Kuwait because of the Amir's support for Iraq. Kuwaiti leaders will look for ways to defuse Tehran's hostility but will continue to support Iraq and tough internal security measures.

Lebanon: Fundamentalist-Christian Cooperation

5

The Lebanese Forces, a hardline Christian group, may have entered into a tactical alliance with Jundallah, an extremist Islamic fundamentalist group closely tied to Hizballah. The mere possibility that such groups might cooperate underscores the Hobbesian dynamics of Lebanese politics.

Syria: Economic Refuge in Lebanon

13

Traditionally strong economic ties between Syria and Lebanon have grown closer during the decade of Syrian military occupation. Syria is a major market for Lebanon's trade and services, while Lebanon offers a free and open market for foreign exchange and imported goods, compensating for the failings of Syria's official economy.

Secret  
NOFORN NO CONTRACT  
OR FORN

17

Arab States: Regional Employment Picture Bleak

23

The Arab states face increased unemployment due to the regional recession, and rapid population growth and returning expatriate workers feed the problem and plague government efforts to meet the growing demand for jobs. Persistent unemployment will contribute to social unrest and increase political pressures on many regimes in the region.

Pakistan-Afghanistan: Where Exports Are Imports

27

The Soviet invasion of Afghanistan has caused a major change in the balance of trade between Kabul and Islamabad and in the kinds of goods traded, as well as a considerable increase in the amount of smuggling.

India: Drug Money Fuels Corruption in Rajasthan

31

The Indian state of Rajasthan is a focal point for the trafficking of Pakistani heroin through India and a center for the diversion of opiates from India's large legal opium cultivation areas. The profits from Rajasthan's illicit drug traffic underwrite widespread corruption among Indian officials and threaten to embarrass Prime Minister Gandhi.

Brief

Middle East-South Asia: Chernobyl Contamination Restricts Food Imports

35

Secret

Near East and  
South Asia Review

Articles

Kuwait-Iran: Escalating  
Tensions

Relations between Kuwait and Iran have deteriorated sharply over the past year due to increased Iranian attacks on Kuwait-bound ships and Iranian-sponsored subversion in Kuwait brought on by continued Kuwaiti support for Iraq. Kuwait's request for Soviet and US protection for its shipping, the issue of Shia prisoners, and Kuwait's cheating on oil production quotas have also fueled Tehran's anger. If Kuwait remains defiant, Iran may escalate its subversive campaign by staging an airstrike against Kuwaiti oil or port facilities. Faced with increasing Iranian pressure, Kuwaiti leaders will look for ways to defuse Tehran's hostility but will maintain support to Iraq and continue tough internal security measures.

Wartime Antagonism

As Iraq's militarily weak but generous financial backer, Kuwait has been singled out as a primary target of Iranian antagonism since the outbreak of the Iran-Iraq war. Iranian aggression toward Kuwait has been demonstrated in several areas over the years;

- Iran has directed the preponderance of its attacks in the Gulf against commercial vessels serving Kuwaiti ports.
- Iran has hit at least 60 tankers since it began targeting Persian Gulf shipping in 1984.
- Iran has sponsored numerous terrorist acts by local Shia supporters intended to destabilize the Kuwaiti Government.

• Iran embarked on a heavyhanded, but unsuccessful campaign to disrupt this year's Islamic Conference meeting in Kuwait by threatening reprisals against visiting Arab dignitaries and launching two missiles from Al Faw. Iran probably also was behind several explosions in the city of Kuwait and neighboring oilfields shortly after the meeting opened.

• Most recently, Iran has stepped up its rhetoric against Kuwait's efforts to seek US, Soviet, and West European protection for its shipping and has warned of possible retaliation if Kuwait draws the superpowers into the Gulf.

Kuwait and Iran have long held opposing views on oil production and pricing policy in OPEC. Iran has traditionally advocated higher prices at any cost, while Kuwait has held to a more moderate position of lower and more sustainable prices. Although the two camps joined forces at last year's OPEC meeting, diverging Iranian and Kuwaiti views have reappeared in recent months. Iran's efforts to increase oil prices could be an irritant at this year's OPEC meeting scheduled for June and in bilateral tensions with Kuwait.

Longstanding mercantile interests between Kuwait and Iran have ensured that trade between the two countries has remained fairly stable over the years, despite stormy political relations. Although Kuwaiti exports to Iran declined from a peak of \$260 million in 1980 to only \$68 million in 1982, they rose again in 1985 to \$204 million. Kuwaiti exporters of oil and related equipment have found ways to circumvent the war's disruption on

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### Historical Cooperation

Historically, Kuwait and Iran have had good relations. Trade has been the cornerstone of the relationship, and Kuwait has traditionally served as a major transshipment point for goods headed to and from Iran. People also have moved freely between the two countries, and descendants of Iranian settlers are among Kuwait's most prominent businessmen. Under the reign of the Shah, Kuwait's ruling family looked to Iran as a buffer against Iraq's historical claims to Kuwaiti territory. ~~SECRET~~ B3

The rise of the Khomeini regime in 1979 and the outbreak of the Iran-Iraq war the following year led to a fundamental shift in Kuwait's policies toward Baghdad and Tehran. The Shah's successors wasted no time in making clear their hostility toward the Sunni Muslim rulers in Kuwait. Moreover, Kuwait's refusal to grant refuge to Khomeini following his expulsion from Iraq in 1978 contributed to the new regime's contempt of Kuwait. ~~SECRET~~ B3

Although Kuwait initially proclaimed its neutrality in the Iran-Iraq war, it soon assumed a pro-Iraqi tilt. Kuwaiti leaders, concerned over the appeal that a radical Shia regime would have among the 30 percent of their country's population that is Shia and the large Iranian community, felt compelled to oppose Iran's expansionist designs. The ruling Al Sabah family perceived a victorious Iran as a greater and more immediate threat to their legitimacy than Iraq. Kuwait then began providing significant political, logistic, and financial support to Iraq. ~~SECRET~~ B3

trade by shipping products through Dubai. In return, Iran has continued its exports of foodstuffs—primarily pistachios, caviar, and dates—to Kuwait. ~~SECRET~~ B3

### Handling Tehran's Aggression

Kuwait's main line of defense against Iran has been to avoid confrontation. To limit Iranian harassment, Kuwaiti leaders and the press have generally ignored Tehran's hostile rhetoric. Kuwait has maintained

strict public silence over its financial support for Iraq—currently valued at \$10 billion—and its role as a transshipment point for Soviet military supplies to Iraq. ~~SECRET~~ B1, B3

In an uncharacteristically bold move in defiance of Iran this spring, Kuwait requested Soviet and US protection of its ships traveling in the Gulf. ~~SECRET~~ B1, B3

For the most part, Kuwait has refrained from responding militarily to Iranian attacks. ~~SECRET~~ B1, B3

Kuwait's liberal rules of engagement, which allow pilots and air defense commanders to fire on unidentified aircraft without higher authority, indicate that Kuwait is prepared to engage Iranian aircraft when necessary. ~~SECRET~~ B1, B3

~~SECRET~~ Kuwait, however, can

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do little on its own against Iranian ship attacks as Kuwait's nascent navy is ill equipped to protect the country's commercial shipping fleet beyond Kuwait's territorial waters. [REDACTED] B3

Domestically, Kuwait's tough response to Iranian-sponsored terrorism has increased sectarian tensions, posing serious problems for the government. [REDACTED] tensions between Sunnis and Shias increased sharply following the arrests of 12 Kuwaiti Shias for oilfield bombings in June 1986 and January 1987. Some local Shias demonstrated against alleged government torture of the detainees and the confiscation of cash and jewelry from their families.

Kuwait has refrained from publicizing Iran's involvement in subversive activities to help preserve bilateral relations.

The Kuwaiti Government has kept diplomatic channels open and active, despite having recalled its ambassador from Tehran early in the war. [REDACTED] a dialogue is essential to mitigate Iran's hostility, gauge Iranian intentions in the war, and discuss OPEC oil policy. Kuwait, as chairman of the Islamic Conference for the next three years, views itself as a possible mediator in the Iran-Iraq war and hopes to encourage Iranian responsiveness to peace efforts. Consequently, Tehran's envoys have little

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difficulty meeting with Kuwaiti Government officials.

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#### Prospects

Relations between Kuwait and Tehran are likely to remain tense for some time. Iran will probably attempt to intensify its attacks on Kuwaiti shipping, increase its support for Shia dissidents in Kuwait, and sponsor more terrorism against Kuwait. If terrorism fails to change Kuwait's policies, Tehran probably is prepared to implement contingency plans for limited air attacks against Kuwait, last undertaken in 1981. Iran may calculate such attacks would not provoke US or Soviet retaliation. [REDACTED] B3

- Kuwait is likely to urge the Gulf Cooperation Council to take a stronger stand against Iran, but its request will probably fall on deaf ears. [REDACTED] B3

Kuwaiti leaders could be compelled to rethink the extent of their support to Iraq and their turn to the superpowers if Iran undertakes a sustained and effective campaign of terrorism and subversion coupled with periodic military strikes that threaten to shut down Kuwait's oil production. In that event, Kuwait might place conditions on or even restrict Iraqi use of Kuwaiti airspace. Kuwaiti leaders could also limit the number of convoys transporting arms to Iraq through Kuwaiti territory and insist that Saudi Arabia increase its shipments through the port of Yanbu. Kuwait, however, is unlikely to completely cut off support to Iraq. [REDACTED] B3

Kuwait's mercantile mentality will restrain Kuwaiti leaders from undertaking actions that might damage long-term commercial relations. [REDACTED]

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[REDACTED]  
Faced with the possibility of increased Iranian-sponsored subversive activities, Kuwait has little choice but to continue tough security measures such as deporting Iranian workers and removing Kuwaiti Shias from jobs in the oilfields, the military, and government institutions. [REDACTED] B3

Kuwaiti leaders probably know that they would get little tangible international support against a more aggressive Iran or following an Iranian attack. Therefore, Kuwait will try to avoid sharper confrontation and will look for ways to reduce Iranian hostility:

- Kuwait will probably minimize the trials of Shia terrorists and the reflagging of Kuwaiti ships.
- The Kuwaiti press will probably increase its criticism of superpower involvement in the Persian Gulf to put distance between Kuwait and US policy in the region.

Regardless of who wins the war, Kuwait would quickly look for ways to exploit the newfound peace, hoping to benefit economically from postwar reconstruction efforts in Iran as well as Iraq. Kuwaitis, however, probably believe that no significant improvement in bilateral ties is likely until the current Iranian leadership changes or the war is over. [REDACTED] B3

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# Lebanon: Fundamentalist-Christian Cooperation? [REDACTED] B3

In Lebanon, the ancient principle that the enemy of an enemy is a friend apparently can bridge even the widest ideological differences. Recent evidence suggests a hardline Christian group has entered into a tactical alliance with an extremist Islamic fundamentalist group. The mere possibility that groups like the Christian Lebanese Forces militia and fundamentalist Islamic Unification Movement—closely tied to Hizballah—might cooperate underscores the Hobbesian dynamics of Lebanese politics. [REDACTED] B3

The fluidity of militia politics may have reached a new high in February as several West Beirut militias—the Druze Progressive Socialist Party, the Communists, and other leftists—joined forces to challenge Amal, Lebanon's largest pro-Syrian Muslim militia. After Amal lost control of a substantial amount of turf, Damascus bolstered its earlier deployment of about 1,000 observers in West Beirut with another 8,000 troops in late February. In the last few months Beirut's militias have begun to rebound, risking reprisals from Syrian troops whose orders are to keep armed elements off the streets. The militias are forming new alliances in response to the current balance of power in Beirut. [REDACTED] B3

The chances are better than even that the Lebanese Forces opened discussions because of the Syrian threat. The Lebanese Forces—which favors the partition of Lebanon into Christian and Muslim ministates—and the Shia Muslim Hizballah—which favors a fundamentalist Islamic state in all of Lebanon—are among the groups threatened by Syria's troops in West Beirut and have much to lose if Syria expands its security plan. Although there is little evidence of sustained cooperation between these otherwise incompatible groups, their perceptions of an increased Syrian threat may spur a coordinated response. [REDACTED] B3

## Guerrilla War in Beirut? [REDACTED]

For now Hizballah is trying to avoid provoking Damascus, [REDACTED] B1 B3

Already the Shia fundamentalists are using their longstanding tactical alliance with the Palestinians to retaliate against the Syrians. [REDACTED] B1 B3

Recent Syrian arrests of Muslim Brotherhood members or sympathizers tend to corroborate these reports. [REDACTED] B3

We believe that Hizballah has been active in the resistance to the Syrian presence. Since the deployment there have been roughly 100 explosions in West Beirut, the vast majority apparently intended as signals of opposition to the Syrian security plan. There is little reason to believe that one group is primarily responsible for these bombings. We suspect that virtually every Lebanese political actor but Amal opposes the expanded Syrian presence. [REDACTED] B3

## Christian Opposition to Damascus

The Lebanese Forces militia is the military arm of the Christian hardliners. Under Samir Ja'Ja's leadership, the Lebanese Forces represents a significant obstacle to the expansion of Syrian influence in Lebanon. The Christian militia was responsible for many of the car bombings in West Beirut after the Syrian observers' [REDACTED]

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deployment to West Beirut on 4 July 1986.

over the ultimate fate of Lebanon, Ja'Ja would not be averse to aiding the fundamentalists if it advanced his goal of promoting cantonization.

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Ja'Ja appears to have been the prime mover in opposing the Syrian-backed reopening of Beirut International Airport. He almost certainly made the decision to have the Lebanese Forces shell the airport. He was roundly condemned when artillery fire destroyed a 707 aircraft, and the concerns of insurance underwriters forced the airport to suspend operations for several months. B3

The Lebanese Forces almost certainly believes that following the February deployment Damascus's forces are better arrayed to use military force against the Christian enclave. Syrian forces also retain positions in the strategically important Metn. The deployment of additional Syrian troops to positions near the Green Line increases the credibility of direct Syrian military pressure on the Christians. B3

#### Would the Christians Help Hizballah?

The Christians would have much to gain by cooperating with Hizballah, at least in the short term. Planting guerrilla-style explosive devices near Syrian military targets would make it harder for Syria to maintain order and will keep thousands of Syrian troops preoccupied with security duties in West Beirut. More fighting or explosions would tend to keep the Syrians busy in the already patrolled quarters of West Beirut. Despite the increased number of Syrian troops in the Muslim quarters and the importance of Syrian positions along the Green Line, the Lebanese Forces probably believes Damascus would defer a military confrontation with the Christians while there was opposition to its security plan in the western sector. B3

From the Christian militia's perspective, aiding Hizballah could speed up disintegration of the current Lebanese political system and hasten the formation of the cantons Ja'Ja advocates. Both Ja'Ja and the Hizballah leadership favor the overthrow of the existing order. We suspect that, despite differences

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#### Would Hizballah Help the Christians?

Like other Lebanese groups, Hizballah has demonstrated considerable tactical flexibility, evidenced by its relationships with Iran and the secular pro-Arafat PLO. Cooperating with Ja'Ja to weaken the Syrians could offer Hizballah greater freedom of action. The two groups' shared goal of overturning the current political system offers a powerful inducement toward cooperation. B3

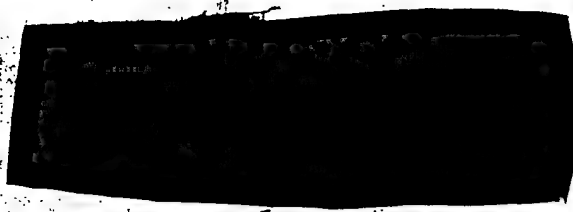
Like the Christians, Hizballah wants to keep the Syrians from expanding their security plan. Preventing the Syrians from entering Beirut's southern suburbs has become the fundamentalists' main priority. Hizballah—like the Christians—would favor a resistance to the Syrian presence that kept Damascus busy maintaining order in the sectors of Beirut it already patrols. B3

Of all the political actors in Lebanon, however, Hizballah is the most dogmatic, and cooperation between Hizballah and the Christians probably would be only temporary. For the Hizballah rank and file, hardliners like Ja'Ja are symbols of the Christian-dominated order that Hizballah wants to sweep away. In the long run the two groups will differ over the fate of the Christians in the south, who inhabit a region that is predominantly Shia. B1, B3

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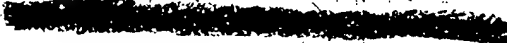
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**Outlook**

We believe that Hizballah and the Lebanese Forces will at least discuss cooperating against the Syrians in West Beirut and may well coordinate underground anti-Syrian operations. It is also possible—in a uniquely Lebanese way—that such coordination would take place while the two groups were carrying out hostile operations against each other. Both groups will take opposite sides on key issues in the long run and probably will not establish a durable relationship, but the imperative to survive in Beirut and the groups' shared short-term goals will encourage them to cooperate against their common enemy.

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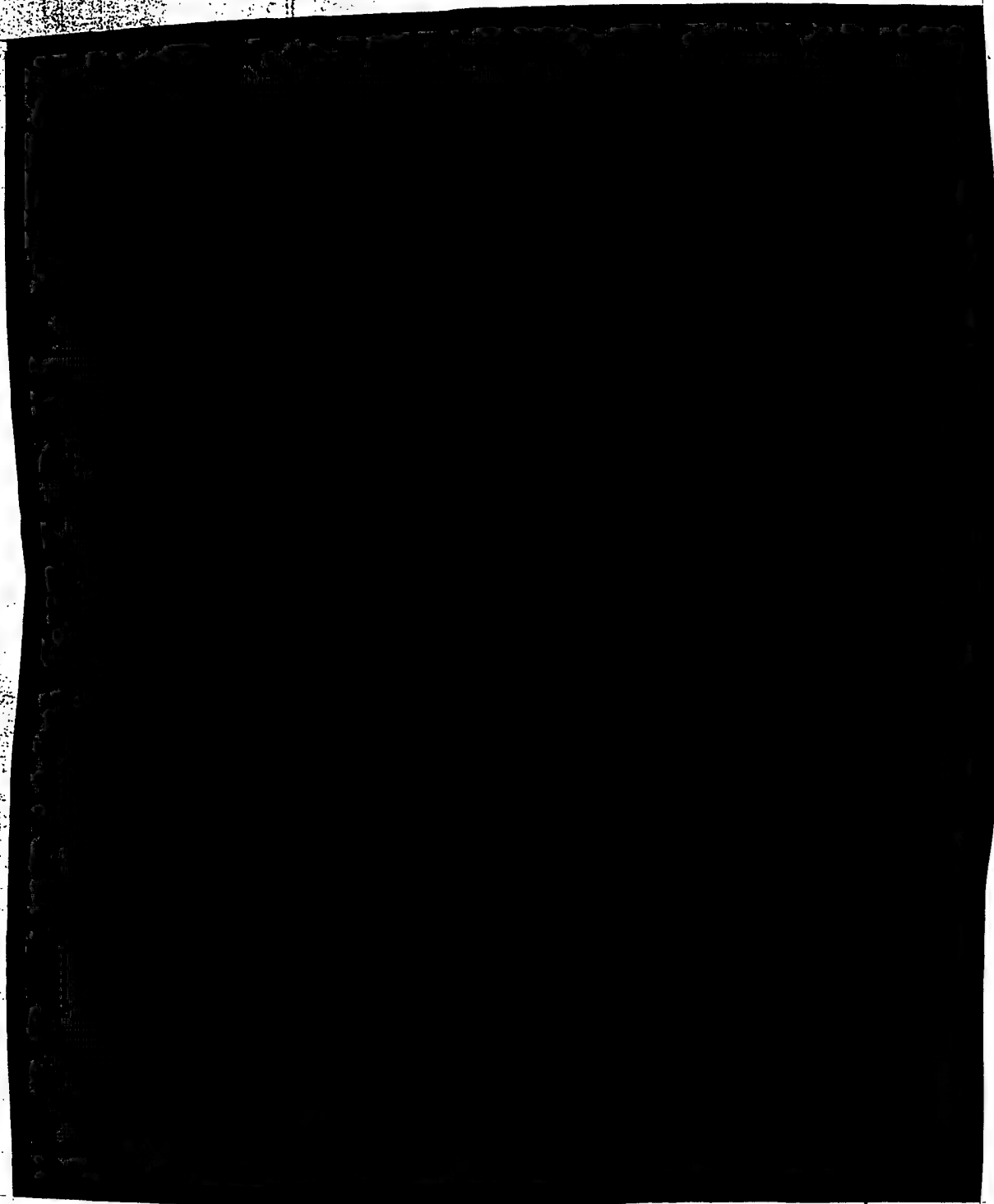


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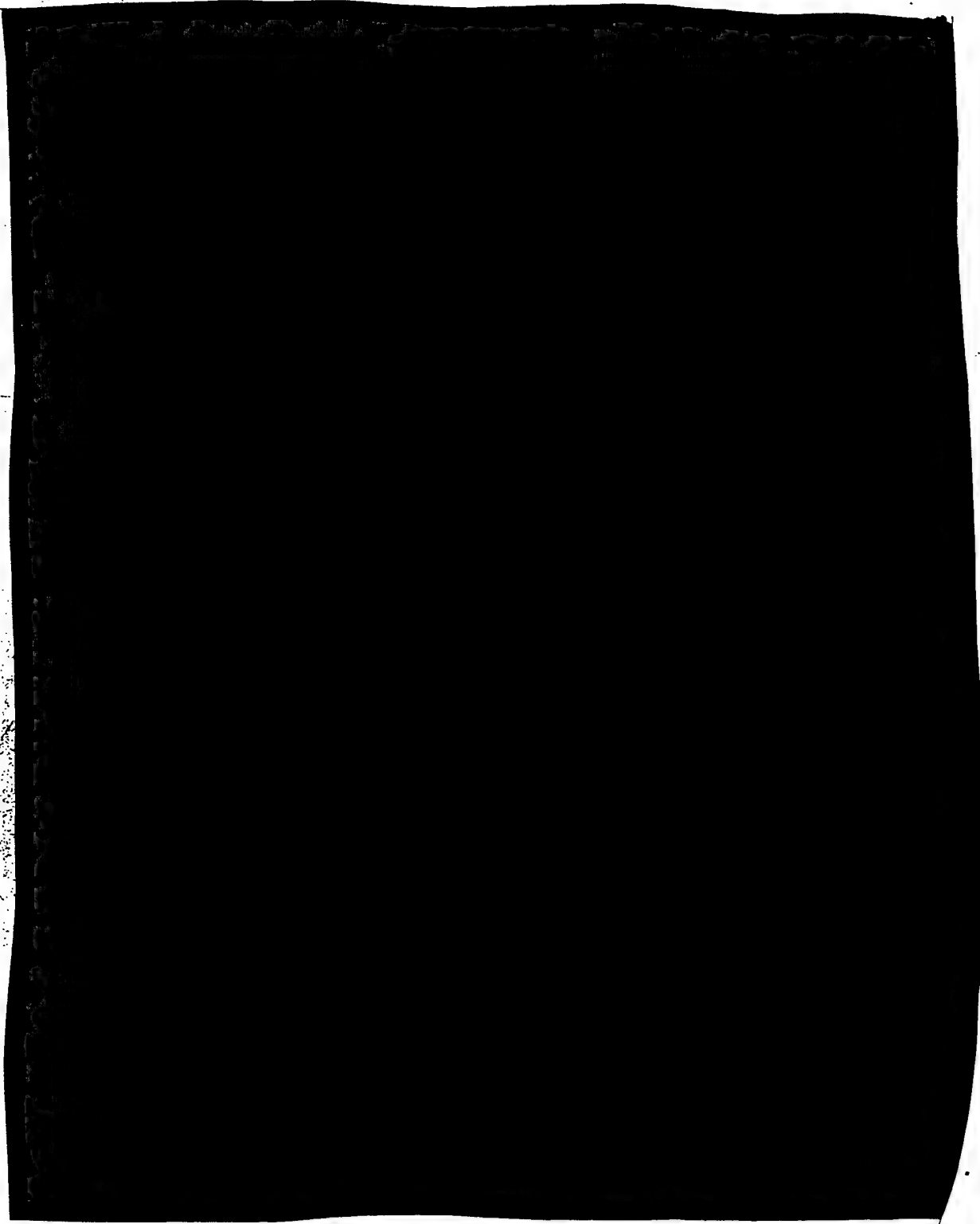
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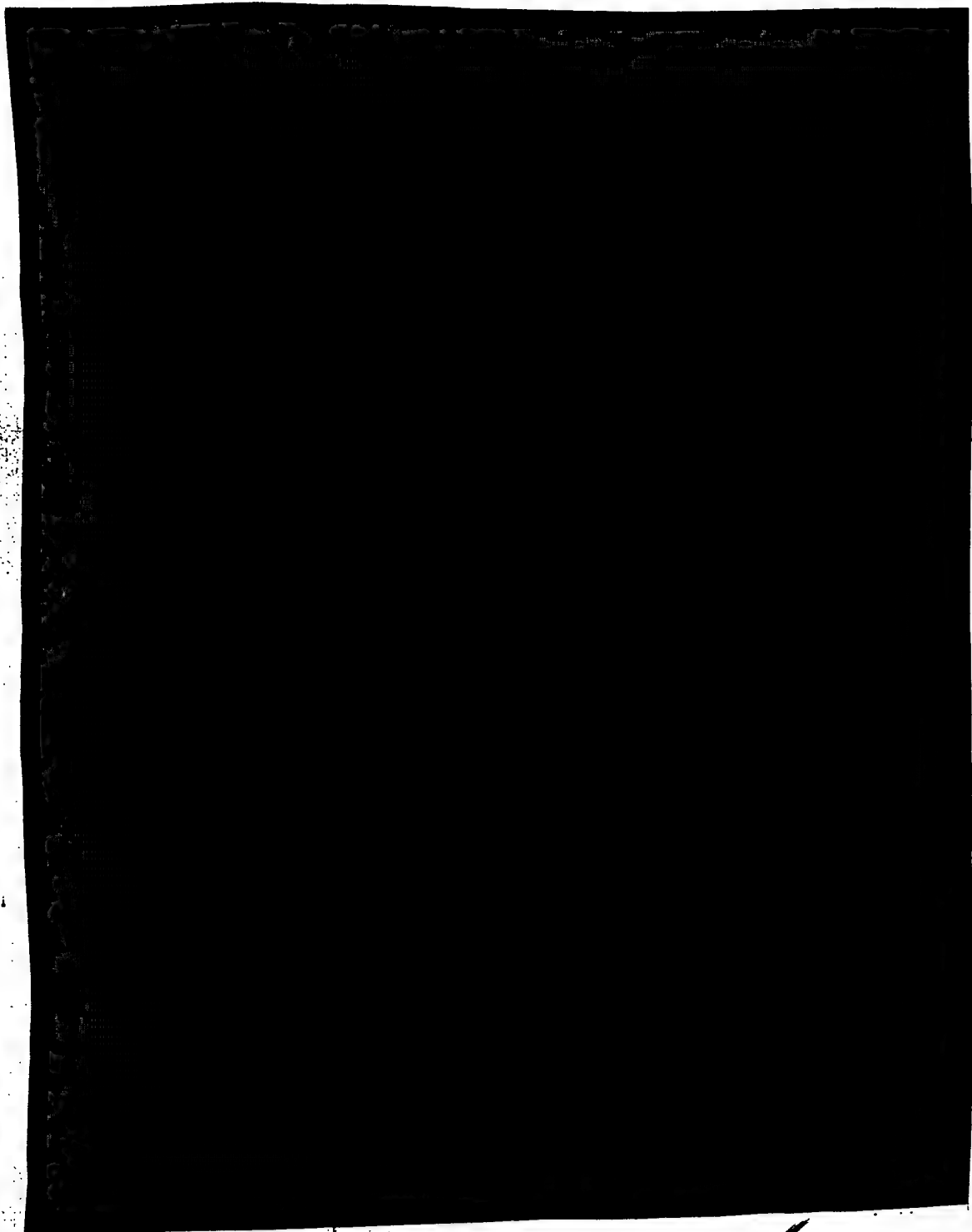
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**Syria: Economic Refuge  
in Lebanon**

Traditionally strong economic ties between Syria and Lebanon have grown closer during the decade of Syrian military occupation. Although philosophically opposed, the two economies complement each other. Syria is a major market for Lebanon's trade and services, while Lebanon offers a free and open market for foreign exchange and imported goods, compensating for the failings of Syria's official economy. Smuggling through Lebanon and black-market activity sustain Syria's small private sector, its government and party elites, and its substantial middle class. As a result, the Syrian economy will continue to limp along even though chronic foreign exchange shortages and poor economic management will limit performance of the predominantly state-controlled industrial and agricultural sectors.

**Syrian Reliance on the Black Market**

The Syrian economy has been shrinking in real terms since 1982—contrary to official statistics—and chronic foreign exchange shortages represent a crisis for President Assad's regime. public and private businesses have been forced to close or reduce operations for lack of imported raw materials and manufactured goods. We estimate that Syria's current account deficit amounted to about \$570 million in 1986, due primarily to lower oil export revenues, reduced expatriate worker remittances, and insufficient levels of hard currency support from Arab donors.

Lebanon's chaotic open economy is an ideal complement to the tightly controlled, stagnant Syrian economy. Syria's system of nationalized banks, rigid exchange controls, and unrealistic exchange rate drains most foreign exchange from Syrian investments and remittances from expatriate workers. private importers rely on an illegal currency market and external financial resources. Syrian moneychangers who supply importers with foreign exchange are forced to operate clandestinely and with limited market information. Many private importers turn to Lebanon for foreign

**Hardships for a Syrian Importer**

Syria's private importers are faced with a "no-win" situation under Syrian import regulations and foreign exchange controls. The foreign exchange needed to purchase imports has not been made available by the Syrian Commercial Bank to private importers since 1985. Therefore, all imports must be financed by external resources, often from hard currency resources held in Lebanon. about \$200 million of Syrian imports in the past two years were financed by the large sums of money held abroad by Syrian businessmen. This supply is slowly being depleted. Expatriate worker remittances are decreasing, and Syrian currency can no longer be legally transferred outside the country by a Syrian citizen.

exchange to finance import transactions. Smuggling and other black-market transactions offer several benefits to the Syrian regime:

- Smuggled imports and Lebanon's banking system provide a safety valve for Syria, limiting popular discontent over the economic decline.
- Smuggling through Lebanon subsidizes the Syrian elites and enhances cooperation and dependence between key leaders and factions in both countries.
- Smuggling and drug trafficking in Syrian-occupied areas in Lebanon supplement Syrian Army salaries and Lebanese militia revenues.

**Syria's Hong Kong**

Lebanon has a well-developed financial infrastructure that compensates for Syria's economic deficiencies. Foreign exchange transactions and capital transfers are unregulated in Lebanon. Lebanon has unrestricted access to imports and a relatively open

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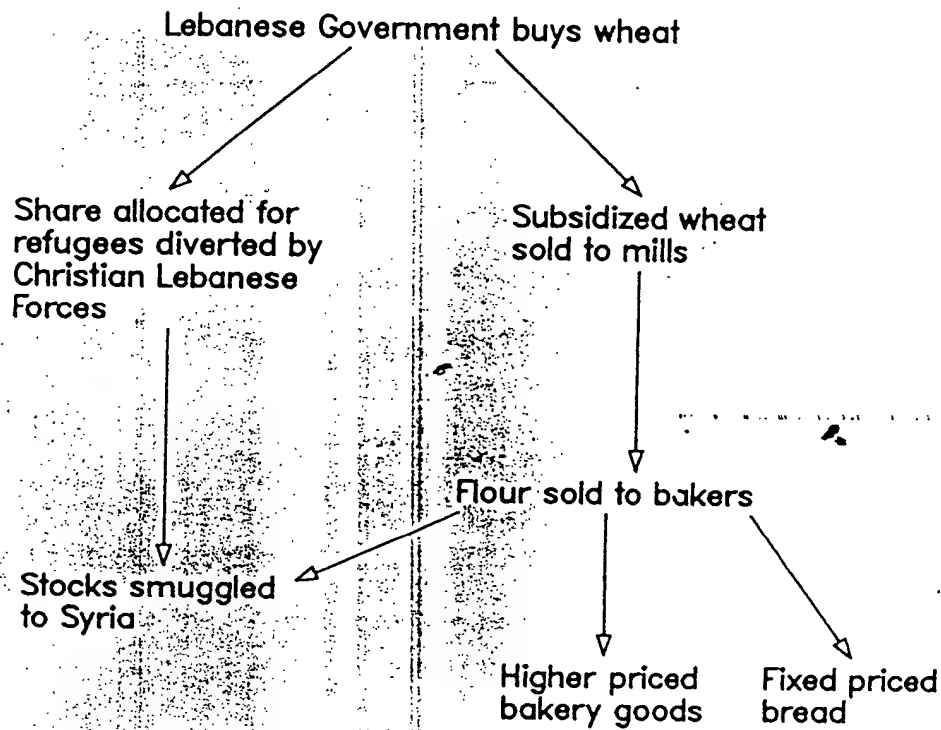
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## Lebanon's Pathway for Smuggled Wheat and Flour



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border with Syria. Lebanon's Bankers' Association statistics indicate that there are over 620 branch banks throughout Lebanon, many of which are geared toward international trade and finance. Banks in Beirut, Tripoli, and in the Bekaa Valley provide letters of credit for Syrian importers to purchase foreign exchange for imports of raw materials and manufactured and consumer goods from the West. Recent statistics indicate local banks still hold over \$2.8 billion in hard currency accounts, much of which is almost certainly devoted to financing Syrian imports.

Lebanese trade with Syria is crucial for Lebanese merchants and manufacturers. Latest statistics from Lebanon's Chamber of Commerce for the North indicate 67 percent of the region's exports are to Syria, 52 percent of which are of Lebanese origin. Almost all imports destined for Syria are channeled through militia-controlled ports and are not subject to customs duties. One operator of Christian militia-controlled ports in Lebanon said last year that 80 percent of his cargos are destined for Syria. Syria's longstanding military occupation in northern Lebanon and now in West Beirut facilitates smuggling.

The most crucial economic link between Syria and Lebanon is in the supply of key imports like grains and fuel. Both countries provide heavy subsidies for these politically sensitive commodities, but the price differential and periodic shortages in Syria promote smuggling of Lebanese stocks.

**Wheat.** Beirut Chamber of Commerce statistics indicate that grains comprise almost 75 percent of Lebanon's legal reexports, although this amount probably excludes much of the smuggled wheat and flour. Lebanon's Cereals and Sugar Beets Office purchases wheat for about \$110 per metric ton and sells it to millers at a subsidized price equivalent to \$8 per metric ton. The official retail price for Arabic bread is fixed at 6 cents per kilo. As a result, substantial profits accrue to smugglers who can supply the Syrian market with the highly subsidized Lebanese supplies.

**Gasoline.** Lebanese oil imports in 1986 were fairly high—about 35,000 barrels per day—and in past years Beirut Port

#### Syria-Lebanon: Relative Gasoline Prices

Retail price per 20 liters

Date	Lebanon *		Syria		Lebanon/ Syria
	Local Currency Price	US \$ (Market Rate)	Local Currency Price	US \$ (Black- Market Rate)	
November 1985	80	4.57	56	4.82	.95
September 1986	110	2.52	76	5.07	.50
May 1987	190	1.56	150	5.00	.31

\* As the Lebanese currency has depreciated—77 percent in the past year—the dollar value of Lebanon's gasoline has fallen. At current market exchange rates, the price of Lebanon's gasoline is 31 percent of Syria's retail price, a highly profitable margin for smugglers who can transport stocks to Syria.

alone imported enough petroleum to meet domestic consumption. Nevertheless, distribution problems and smuggling often create shortages of gasoline in Lebanon.

The Christian Lebanese Forces militia diverts fuel supplies to Syria, especially during periods of severe Syrian shortages. Despite repeated domestic fuel price increases by the Lebanese Government—prices have been raised over 500 percent since early 1984—the rapid deterioration of the Lebanese pound has reduced the dollar value of gasoline and encourages widespread smuggling to Syria.

#### Syria Keeping the Upper Hand

The Assad regime launches periodic crackdowns against smuggling and illegal currency transactions, but Damascus generally tolerates the black market. In late 1986 Syria enacted a law prohibiting Syrians from transporting Syrian currency into Lebanon, thus preventing private importers from paying their Lebanese suppliers and practically stopping the Lebanon trade for nearly two months.

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[REDACTED] Damascus probably wants to bring more foreign exchange transactions into official channels—official reserves average less than \$50 million. The regime hopes to appear committed to resolve economic problems. Highly publicized arrests of merchants and "corrupt" officials and tightened border controls are a visible policy response. [REDACTED]

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Syria will remain dependent on Lebanon for many essential goods and services. Despite border controls, we believe Syrian Army personnel still purchase and often requisition goods from establishments inside Lebanon, supplementing their poor salary and allowances. Underground trade provides a safety valve against more open public discontent over economic conditions and Assad's heavyhanded policies. The Lebanon trade will continue to benefit domestic economic elites who exploit influential connections with the government and military to provide smuggled goods and illegal services. [REDACTED]

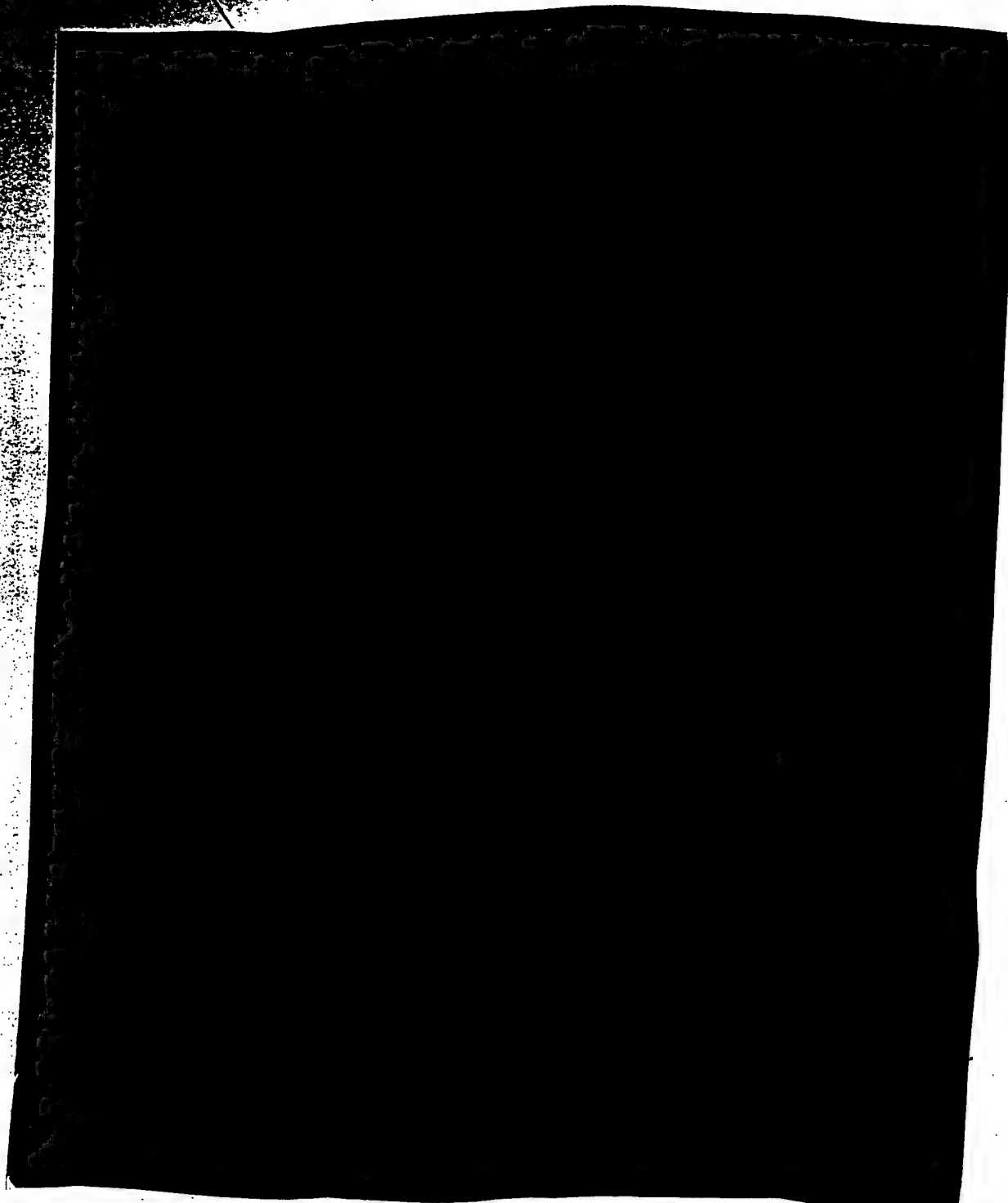
The economic cushion provided by Lebanon and the black markets makes Damascus less susceptible to financial pressure from Arab or other states than the state's dismal economic performance would imply. Even though Damascus is experiencing a severe cash squeeze and increasing shortages of staple goods, Assad will be sheltered from public discontent by economic ties to Lebanon. [REDACTED]

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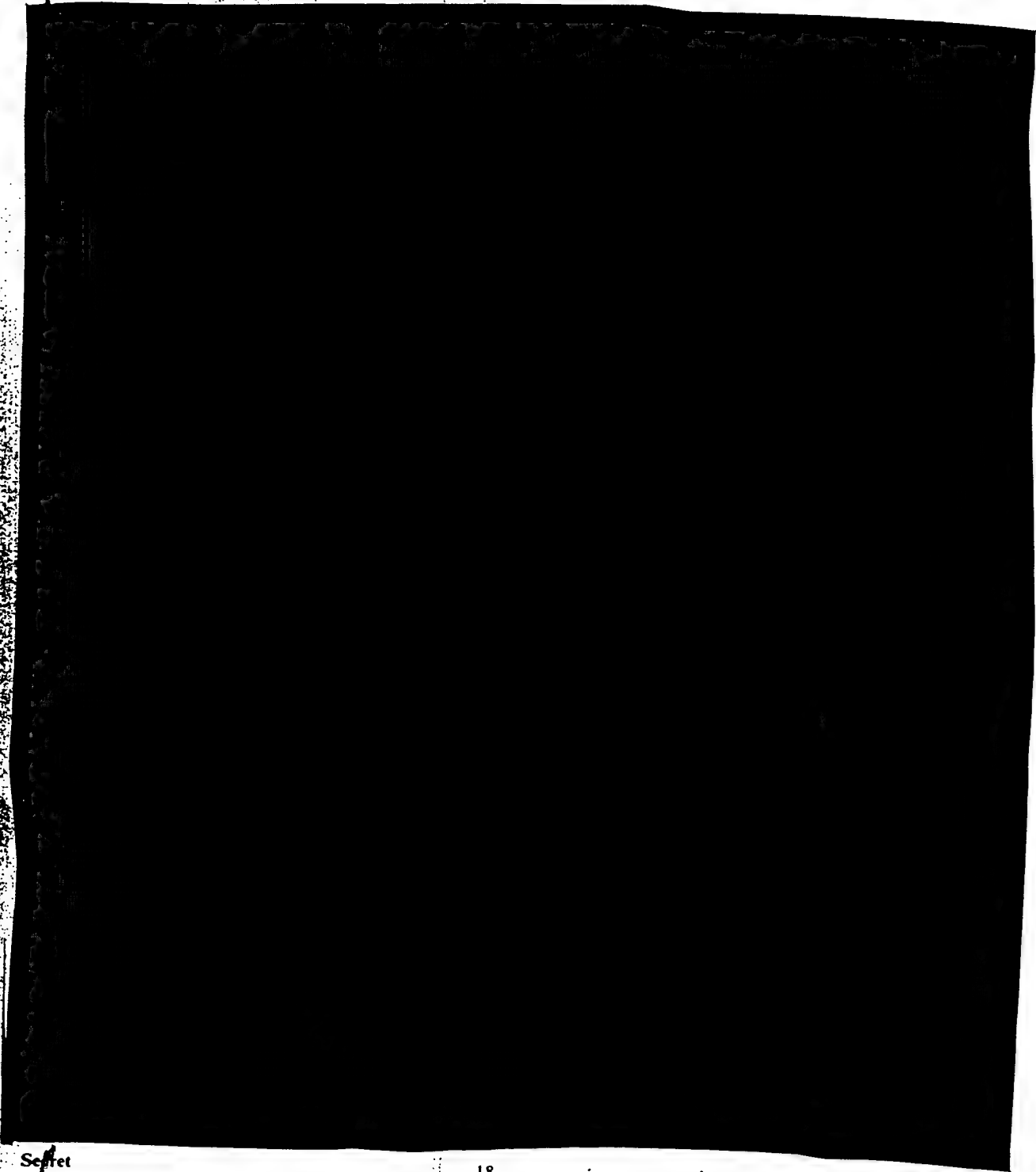
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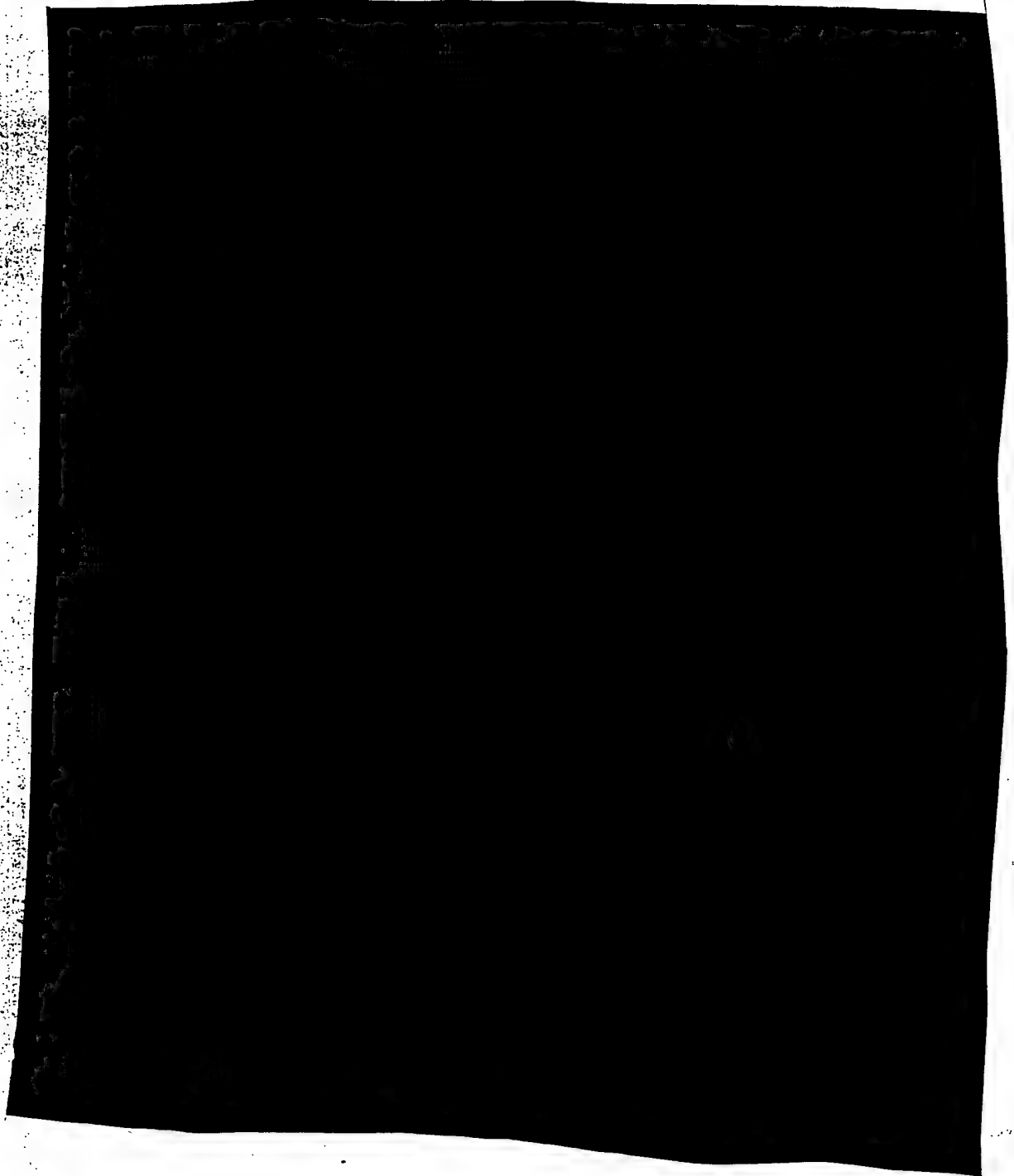
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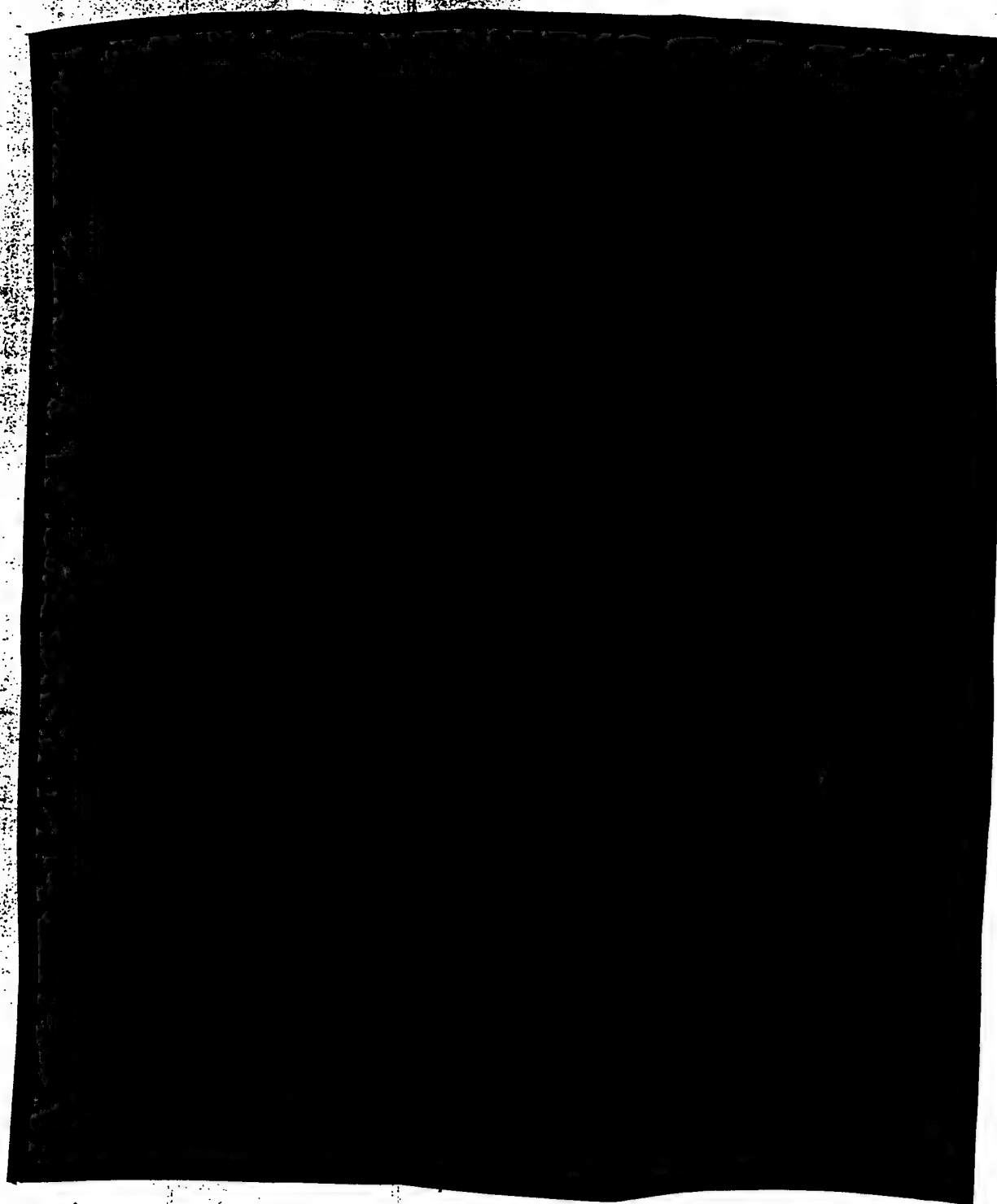
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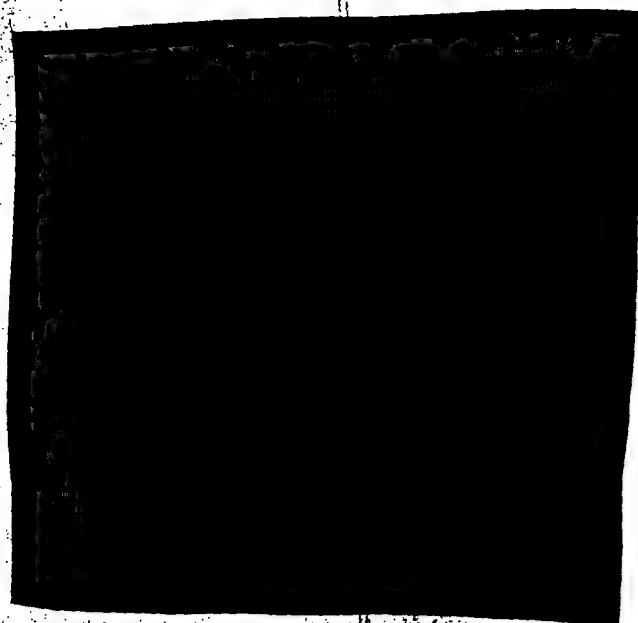


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**Arab States: Regional  
Employment Picture Bleak**

The Arab states face increased unemployment due to the regional recession. Unemployment rates range from 3 percent in the Persian Gulf to 20 percent in the Maghreb countries. Rapid population growth throughout the area and returning expatriate workers in many states feed the problem and plague government attempts to meet the growing demand for jobs. Persistent unemployment will contribute to social unrest and increase political pressures on many regimes, especially Egypt and Algeria.

Employment prospects are grim as the region's economic recession continues. Hard currency earnings are depressed due to weak international markets for oil, petroleum products, phosphates, and natural gas. Lower revenues have forced governments to reevaluate, and often reduce, spending on investment and development projects that would create new jobs.

In addition to the recession, labor-exporting countries such as Tunisia, Morocco, and Egypt face chronic unemployment because growth of the labor force and the population consistently exceeds economic growth. In Jordan, for example, the increase in real GDP slowed to 3 percent annually during 1983-85, while the labor force and population grew at 6 and 3.3 percent, respectively.

Unemployment is further heightened by increasing female participation rates. Another factor is increased urbanization as unskilled peasants move to the cities seeking work. In Morocco, 20 percent of the urban labor force—1.2 million workers—are chronically unemployed because of weak domestic demand for labor and/or lack of employable skills.

Among the labor-importing countries in the Persian Gulf, domestic unemployment is structural and exists primarily within specific groups such as the young and recent college graduates. In Bahrain and Saudi Arabia, Shia Muslims—the most economically disadvantaged group—will feel the brunt of the recession.

**The Statistical Morass**

*There is a lack of reliable statistics on the labor force in the Middle East and North Africa.*

*Given the large, predominantly rural work force in such countries as Morocco and Algeria, accurate statistics are difficult to obtain.*

*Statistical collection methods in use in the Arab world, as in LDCs in general, do not accurately measure the level of underemployment. A person is underemployed if he is eligible for work and does not have a full-time job or has a nonessential job. Employment statistics may be inflated when they include those individuals who are underemployed:*

- In Morocco, family members who contribute marginally to the family income through part-time employment or by working in cottage industries are counted as employed.
- In Algeria, an estimated 40 to 45 percent of the agricultural work force is considered underemployed.
- In Jordan, where the government acts as the employer of last resort, about 25 percent of the Royal Jordanian Airline's payroll and over 50 percent of the Jordan Phosphate Mining Company's workers are underemployed.

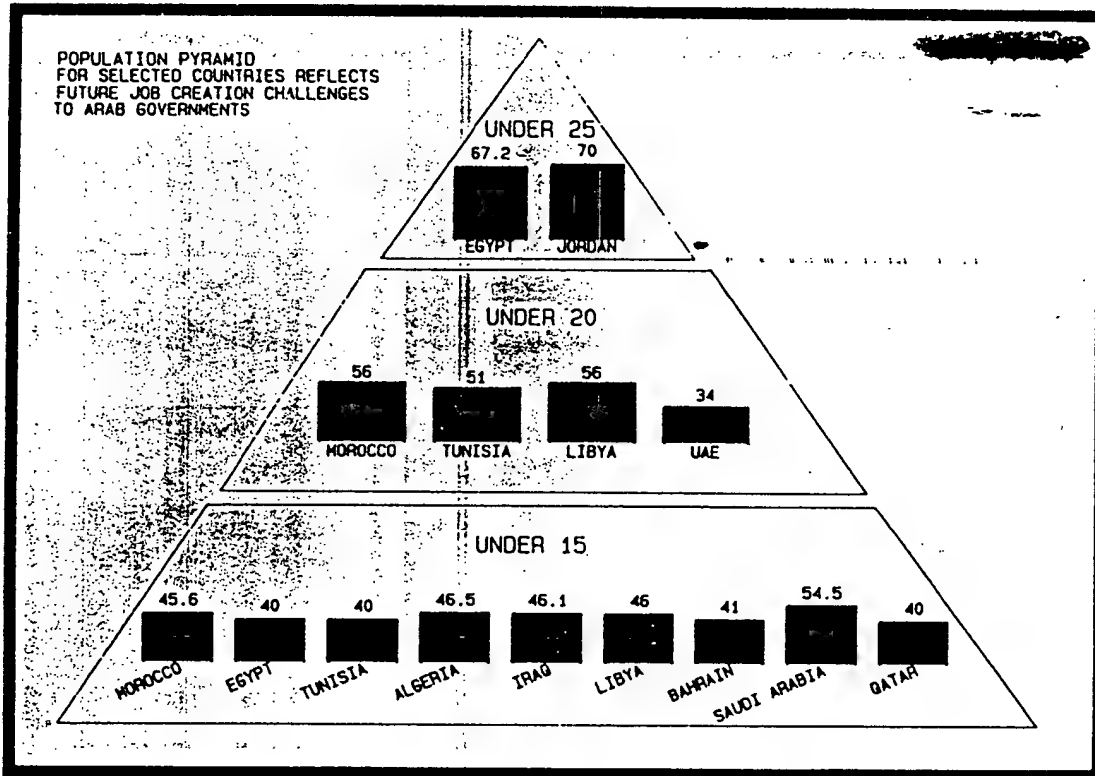
*Although some of the statistics may be outdated or inaccurate, we believe the available data show unemployment trends in the Arab world.*

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Graph 1



#### Youth Unemployment Deepens

High population growth rates in low-income Arab countries have compounded unemployment problems among youth, who account for a disproportionate share of total unemployment. In most Arab countries, over half of the population is under 25, and many are jobless. For example:

- 75 percent of the unemployed in Algeria and Morocco are between 16 and 23.
- 40 percent of Tunisian males between 18 and 26 are unemployed.

We believe the Egyptian Government will be hard pressed to create enough jobs to keep pace with a labor force that is growing at a rate of 3.2 percent or 400,000 per year. Only 33 percent of recent university graduates have been able to find work, the rest waiting up to four years for a government job.

Youth and recent college graduates in oil-producing countries such as Saudi Arabia, Kuwait, and Qatar face dim employment prospects as low oil prices

depress their countries' economies. A college diploma no longer guarantees employment in desired professional positions.

University graduates in Saudi Arabia are receiving reduced wage offers and fewer fringe benefits.

Increased education typically raises job expectations among graduates. In Qatar and Oman, new entrants to the labor force continue to seek nondemanding, middle-management positions with impressive sounding titles, according to diplomatic reporting. These expectations are no longer being met because of the recession and employer needs for well-trained, capable workers.

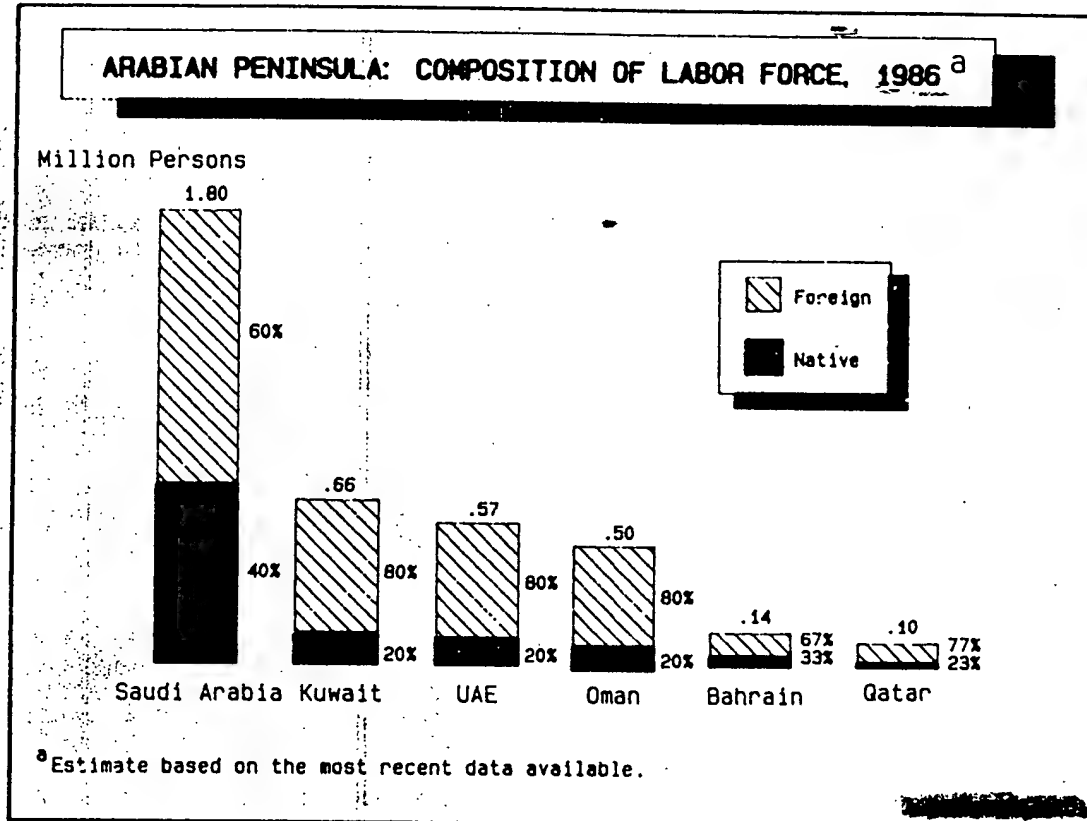
#### Declining Opportunities Abroad

Arab countries that rely on the export of labor to ease their domestic unemployment and provide much-needed foreign exchange have been hurt both by the

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Graph 2



recession in the Arab world and cutbacks in economic opportunities elsewhere. Western Europe, traditionally a safety valve for Morocco, Algeria, and Tunisia, in recent years has reduced its reliance on foreign workers.

Fewer jobs abroad mean greater competition for jobs at home. In Jordan and Egypt, returning workers from the Gulf compete with recent graduates and youth entering the domestic job market. Jordan's unemployment rate of approximately 10 percent may rise by 3 percentage points per year and could possibly reach 20 percent by 1990 unless the government's attempts to stimulate job creation and investment in the private sector are successful.

#### Labor Shortages

The Gulf states are generally experiencing less unemployment and continue to rely heavily on foreign labor. Many expatriate Arab workers, however, have been forced to accept significantly reduced wages and benefits. The foreign work force is increasingly composed of relatively less expensive Asian workers instead of Arabs. In Saudi Arabia, the Sri Lankan and Bangladeshi presence has almost doubled to 180,000 in the last year because they are willing to accept lower wages. We expect the reliance on expatriate labor throughout the region to continue despite official

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attempts to reduce the presence of foreigners in the work force through training and education programs.

In the Gulf states, domestic technical, management, and professional manpower is in short supply. In Saudi Arabia, specialized jobs in medicine, dentistry, computer science, law, and engineering are available, but students continue to favor the social sciences. In some Gulf states, such as Oman, Qatar, and the United Arab Emirates, the demand in all segments of the labor force has far outstripped the availability of native workers.

The Iran-Iraq war has worsened labor shortages in Iraq. Many sectors of the economy, including oil and banking, are understaffed as skilled manpower is rotated through the military. Despite the recruitment of students and other temporary workers, peak seasonal agricultural and industrial labor is in short supply.

Despite high levels of chronic unemployment in other Arab states, labor shortages exist in certain fields and occupations. In Jordan, for example, demand for skilled and semi-skilled workers in construction, agriculture, and industry remains unmet in the rural areas due to poor wages and working conditions as well as the lack of prestige associated with these types of work.

Tunisia needs skilled technical workers, but vocational programs are woefully inadequate for those seeking alternatives to a college education.

#### Outlook

Arab governments are giving high priority to job creation programs as well as technical and vocational training to provide youth and other workers with the skills needed in the job market. Tunisia, which must create 80,000 jobs per year for new entrants over the next 15 years, has developed a four-part plan to increase employment, but training programs are limited by funding constraints. Instead of investing more money in infrastructure and industrial projects, Jordan is concentrating on education and training, investment and export incentives, and other policies to increase the productivity of existing investments and to stimulate the domestic demand for labor.

We believe implementation of effective job creation programs will be harmed by limited private-sector involvement and the lack of vocational and other training programs. Past job creation programs have fallen short of their goals:

- Tunisia's last five-year plan (1982-86) to develop 60,000 new domestic jobs and to find 4,000 jobs abroad per year fell 15-20 percent below the official yearly target.
- Algeria's 1980-85 five-year plan called for developing 1 million jobs, but only 735,000 were created.

Reduced employment opportunities will add to social tensions in Arab labor-exporting countries, especially Tunisia, Algeria, and Egypt. Unemployment woes, when combined with other difficulties such as Islamic fundamentalism, economic austerity, urbanization, and crime, will increase the political challenges for the governments of these countries.

In the labor-importing countries of the Gulf, programs to reduce reliance on expatriate workers will probably continue to flounder due to the small indigenous populations and the scarcity of skilled native workers. The young and minority groups will continue to make up the bulk of the unemployed. Traditional cultural values, which encourage disdain for manual labor and is averse to technical and vocational training, will continue to undermine the governments' attempts at establishing an efficient native work force. As Omanis, Saudis, Qataris, and others continue to shun private-sector employment, we believe the number of expatriate workers will remain stable or decrease only slightly, given current economic conditions. Arab workers from labor-exporting countries will probably have fewer job opportunities in the Gulf unless economic activity improves.

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**Pakistan-Afghanistan:  
Where Exports Are Imports**

The Soviet invasion of Afghanistan has caused a major change in the balance of trade between Kabul and Islamabad and in the kinds of goods traded, as well as a considerable increase in the amount of smuggling. The Soviets have used trade through Afghanistan to make inroads into Pakistani black markets. Trade that transits Pakistan, destined for Kabul, has been disrupted because the Pakistanis themselves have attempted to regulate the trade to slow the diversion of goods into the Pakistani black market. Maintenance of a small level of official trade is important to support the Kabul regime's claim to legitimacy, but the benefits of expanding unofficial trade will make smuggling a more attractive form of trade for both Pakistani and Afghan merchants.

Trade between Pakistan and Afghanistan nearly doubled in the last half of the 1970s. Afghanistan was—at least officially—a net exporter to Pakistan, mainly because of food exports. Besides food, Pakistan imported raw materials and semi-finished goods—such as lumber and carpets—from Afghanistan. More than two-thirds of Pakistani exports to Afghanistan were manufactured goods, mostly cigarettes, leather products, and cotton fabric or yarn. Being landlocked, Afghanistan relied on Pakistan's port at Karachi for much of its imports. Afghanistan's external trade with the Soviet Union accounted for roughly one-third of Kabul's imports and exports in 1979.

**Trade Developments: During the War**  
Officially reported trade between Pakistan and Afghanistan has followed a rollercoaster pattern since the Soviet invasion in 1979, rising considerably during the first two years, dropping precipitously the next two, and then leveling off after fiscal year 1984.<sup>1</sup> Pakistani imports increased from FY1980 to FY1982 and then fell dramatically from FY1982 to FY1986, while exports

have increased almost 25 percent during the last two years. As a result, the trade balance has shifted in Pakistan's favor from a deficit of \$55 million in FY1982 to a surplus of \$3 million in FY1986.

We believe that growing Afghan exports to the Soviet Union, lower production, and increased smuggling have accounted for much of the fall in Pakistan's official import statistics. \$80-100 million in smuggled goods cross the border annually.

Even though Kabul increasingly relies on customs duties on imported goods to fill government coffers, these duties are so low compared with those imposed by Islamabad that there is considerable transit trade from Afghanistan into Pakistan. An Afghan commented that "the only business in Kabul is reexport," claiming that nearly 80 percent of imported goods are reexported to Pakistan. Kabul has purposely kept duties low to ensure that Afghan merchants can import goods, pay the duty, and still smuggle or reexport the goods at a profit. Pakistani restrictions that put heavy tariffs on goods from developed countries and relax duties on imports from less developed countries also provide an incentive for the transit trade.

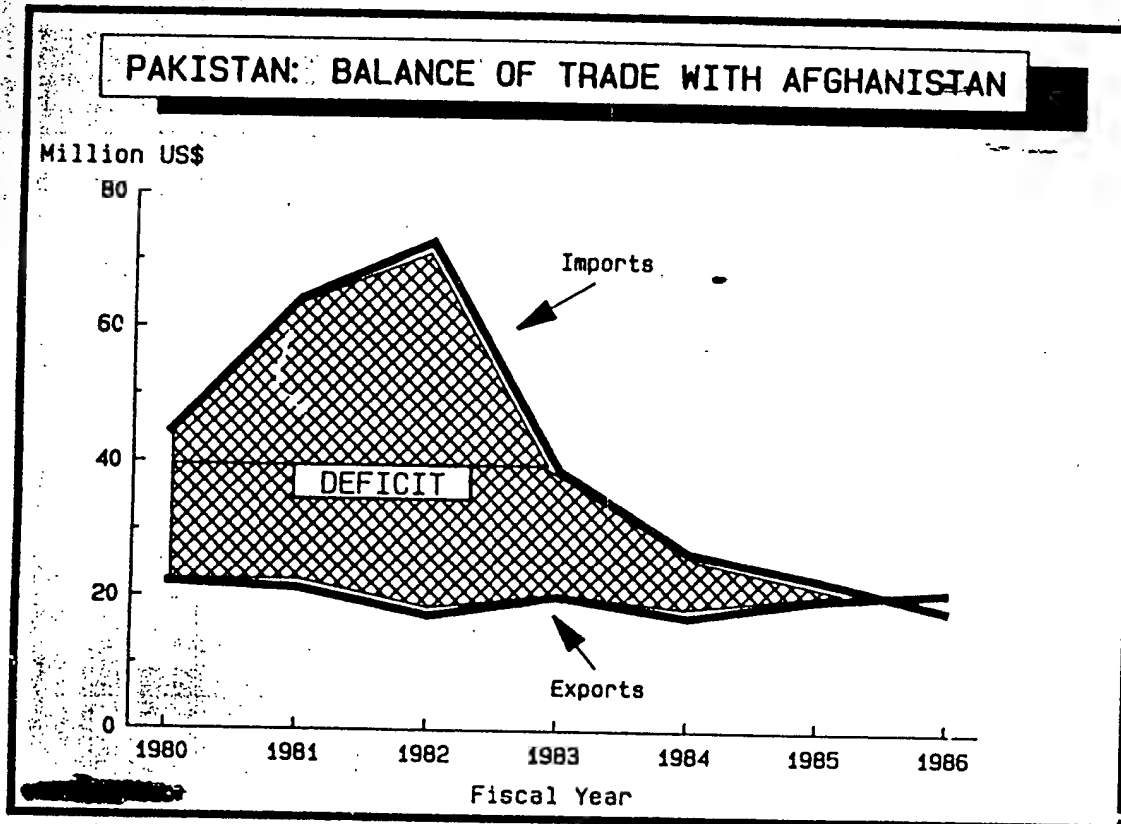
The war and the emigration of nearly one-fourth of Afghanistan's population have significantly changed the kind of goods being traded. Cigarette exports were roughly 14 percent of Pakistani exports to Afghanistan in FY1980, but they have increased to more than 50 percent in FY1986. Most of the cigarettes are smuggled back into Pakistan to avoid a high domestic excise tax. Paper product exports have increased nearly sevenfold from FY1982 to FY1986, probably to be used in

<sup>1</sup> The Pakistani fiscal year begins on 1 July and ends on 30 June.

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packing goods for the expanding reexport business in Afghanistan. A major Afghan product that probably is being produced in greater quantity because of the war is animal hides. Falling agricultural production in Afghanistan has caused locals to rely on the slaughter of animals for income. Hides are becoming an increasingly important export from Afghanistan to Pakistan's growing leather garments industry.

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Official transit trade has fallen because Islamabad now requires that goods transiting Pakistan for Afghanistan be accompanied by a letter of credit on an Afghan bank. Data suggest that 60 to 70 percent of the goods bound for Afghanistan via Karachi never leave Pakistan. Pakistani middlemen divert these goods from the transit trade into black

markets. more than 70 percent of the value of transhipped goods that reach Afghanistan are immediately smuggled back into Pakistan.

B1, B3

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Trade between Pakistan and Afghanistan has been substantially altered by the growing Soviet involvement in the Afghan economy. Afghanistan now relies on the USSR for nearly 70 percent of its external trade. The reorientation of Afghan trade toward the Soviet Union in recent years has resulted in a decrease in the export of some products—particularly fruit and carpets—to Pakistan. Conversely, Afghanistan is importing some goods from Pakistan that are ultimately destined for Soviet

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### Trade Terms Defined

*Official trade refers to goods coming into and leaving official ports of entry that are reported in government statistics based on customs reports. The official reports on Pakistan-Afghan trade only account for those items that are inspected by customs officers at the border.*

*Unofficial trade means those goods smuggled to avoid inspection by customs officials. In the mountainous frontier area of the Pakistan-Afghan border, mules are frequently used to transport smuggled items. By avoiding customs duties, smugglers can sell their goods at discount prices or can offer items that are not officially imported.*

*Transit trade applies to goods that are imported into a country only to be reexported to another country. Afghanistan has typically imported goods through the port of Karachi and then overland across the border. These are not recorded as Pakistani imports. The terms transit trade and reexports are synonymous.*

consumers. [redacted] increased exports from Pakistan to Afghanistan of such luxury food items as tangerines, bananas, chocolate, and confectionary sugar can be attributed to their increased consumption by Soviet soldiers stationed in Afghanistan or the reexport of these products to the USSR.

### The Soviet Angle

[redacted] In our view, the change in official trade patterns over the last several years is more an outgrowth of the developing economic relationship between Moscow and Kabul and—in the case of the rerouting of the transit trade—policy decisions in Islamabad than a Soviet plan to alter traditional Pakistan-Afghan economic relations.

[redacted] Soviet companies have also encouraged the transit trade to Pakistan by offering such incentives as guaranteed delivery and lower shipping rates.

caviar and other Soviet goods abound in the bazaars of Peshawar. [redacted] Moscow may be trying to foster corruption and small-scale sabotage of the Pakistani economy, but we believe their efforts will not have a serious impact on Pakistan's economy because they are so minuscule.

### Winners and Losers

Although official trade with Afghanistan represents less than 1 percent of Pakistan's total trade, it is important for the underdeveloped North-West Frontier Province.

[redacted] Pushtun tribesmen in the province are heavily involved in transporting goods between the two countries, and a substantial portion of Afghan exports to Pakistan are marketed in the North-West Frontier Province. Maintenance of official trade ties to Pakistan also enhances the Kabul regime's claim to legitimacy.

The much larger illegitimate Pakistan-Afghan trade benefits a number of parties on both sides of the border. The Afghan reexport trade is extremely profitable for the Kabul merchants who import the merchandise, the Pushtun traders who transport it to Pakistan, and Pakistani merchants who can offer a discount compared with competing merchandise on which customs duties were paid.

[redacted] the merchants and the traders make profits averaging 15 and 100 percent, respectively. The reexport trade also increases the Afghan regime's revenues from customs duties. In addition, because Afghan merchants receive payment in hard currency, Kabul maintains an important source of foreign exchange by encouraging this trade.

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Moscow has benefited from the rerouting of much of the transit trade away from Pakistan to the Soviet Union. The reexport trade has proven lucrative for joint Soviet-Japanese enterprises that import manufactured goods into Afghanistan. As an added benefit, the Soviets earn hard currency through these firms. [REDACTED]  
Moscow earns hard currency through the handling of transit freight and, at the same time, has increased traffic on the underutilized Trans-Siberian Railway. [REDACTED]

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The losers from the new trade trends are Pakistani Government coffers and the Pakistani middlemen who used to handle the Afghan transit trade through Pakistan. The middlemen complain that Islamabad's letter of credit requirement and other bureaucratic hindrances to transit trade destined for Afghanistan have substantially reduced their business. Islamabad loses out on customs duties on goods smuggled in from Afghanistan, [REDACTED]  
B1, B3  
In addition, since the unofficial trade is financed with hard currency, it acts as a foreign exchange drain on the Pakistani economy. [REDACTED]  
B1, B3  
[REDACTED] the volume of smuggled goods is probably not sufficient to have a serious impact on the overall economy. Furthermore, the influx of smuggled Western consumer goods provides a safety valve for pent-up consumer demand. [REDACTED]  
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#### Outlook

In our view, official Pakistan-Afghan trade will continue to be constrained by the increasing orientation of Afghan trade to the Soviet Union, decreased industrial and agricultural production in Afghanistan, and the diversion of goods into unofficial channels. Nevertheless, Kabul will endeavor to maintain a "basic minimum" of official trade with Islamabad for political and publicity purposes. [REDACTED] B3

We judge that unofficial trade will increase for several reasons. With the decrease in Afghanistan's trade with the West in recent years, the importance to the regime of hard currency earnings from the reexport trade has increased, in our view. Furthermore, most of the economic activity in resistance-controlled areas of Afghanistan will almost certainly continue to take place through unofficial channels. It is unlikely that Islamabad will crack down on smuggling from Afghanistan in the foreseeable future because of its inability to monitor the border, its limited control over the tribal areas, and its interest in keeping the border open for the transit of weapons and supplies for the Afghan insurgents. [REDACTED]  
[REDACTED]  
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**India: Drug Money Fuels  
Corruption in Rajasthan**

The Indian state of Rajasthan is a focal point for the trafficking of Pakistani heroin through India and a center for the diversion of opiates from India's large legal opium poppy cultivation areas. As the state with the longest border with Pakistan, drug interdiction is an increasing problem for both the state and federal agencies responsible for monitoring the movement of contraband between the two countries. Furthermore, the profits from Rajasthan's illicit drug traffic:

- Underwrite widespread corruption among Indian officials and grease their relationships with drug middlemen and Pakistani security officials.
- Are a major factor in subsidizing local election campaigns.
- Threaten to embarrass Prime Minister Gandhi and his ruling Congress Party.

**Something for Everyone in Rajasthan**

We believe drug money augments other forms of corruption Indian politicians employ to raise campaign funds.

**New Delhi's Concerns**

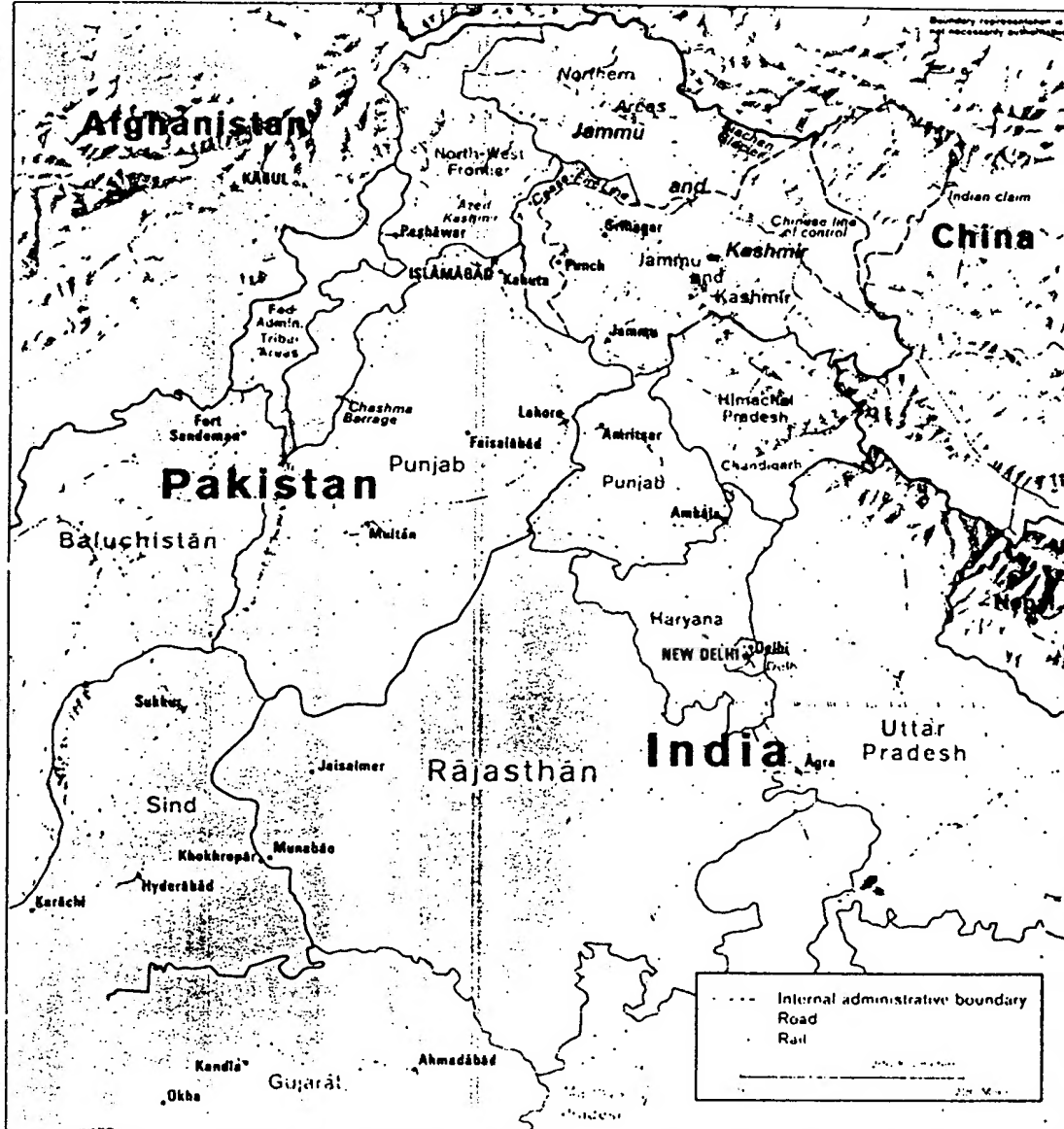
Drug trafficking in the Rajasthan border area is a hindrance to Rajiv Gandhi's political goals in the region. Gandhi wants his Congress Party to continue to rule Rajasthan, but corrupt Congress politicians threaten to undermine the party's strength in the state. Gandhi also would like to demonstrate to Islamabad that his government controls the entire Indo-Pakistani border, including the clandestine movement of contraband.

Drug interdiction efforts in Rajasthan have had only limited success, however, in large part because widespread corruption and kickbacks quickly seduce

India is the world's largest producer of opium gum, producing 750 metric tons in 1985. New Delhi sold 600 metric tons of that year's production to international pharmaceutical companies for the manufacture of processed opiates. About 150 metric tons of opium are used domestically and any excess stockpiled. 20 to 30 percent of the opium crop is diverted to the black market each year before it enters official channels. Of this, most is probably consumed by India's own opium users.

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# The India-Pakistan Border



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even relatively honest, but low-paid, officials.

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parties of opportunities to embarrass the Congress Party on these issues. Although the party controls the Rajasthan state legislature, opposition parties are strong in the key border districts where much of the drug activity is located. Gandhi declared direct rule in the neighboring state of Punjab in May, and his party faces a difficult election in another neighboring state, Haryana, in June. Increased attention to Congress Party corruption and drug trafficking would be particularly unwelcome at this time.

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Gandhi's decision to send the director of the national Narcotics Control Bureau, B. V. Kumar, to Rajasthan in April reflects, in our judgment, a gradual increase in New Delhi's awareness that there is an important security aspect to drug trafficking in key border regions.

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Gandhi also probably is reluctant to try to break the corrupt official-drug trafficker link for fear of embarrassing too many high-ranking members of his own party in Rajasthan. Although Gandhi might welcome the public relations rewards of a program in Rajasthan that simultaneously demonstrated his concern for antinarcotics objectives, security, and clean government, he is not prepared to face a potential expose of leading politicians' involvement in the drug trade. We believe Gandhi will continue looking for opportunities to restore the "Mr. Clean" image given him by the Indian press, but resolving Rajasthan's drug problems—for the immediate future—will probably be limited to reducing further revelations of Congress Party corruption.

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#### The US Role

New Delhi generally spurns foreign involvement in domestic programs and consequently has not approached Western states for help with any proposed antidrug crackdown in Rajasthan. We believe, however, Gandhi would welcome future opportunities to demonstrate his government's commitment to antinarcotics efforts. If New Delhi initiates a successful antidrug program in Rajasthan, Indian officials might seek credit in Washington for responding to US encouragement to reduce India's growing role as a conduit for Pakistani heroin to the West.

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We believe Gandhi was sympathetic to Kumar's recommendations for a campaign against Rajasthan's drug and corruption problems, but he has not focused on the drug issue. We believe Gandhi's prime concern in the state is on military preparedness to offset potential threats from Pakistan. Until Indian drug interdiction officials can convince the Prime Minister that controlling the flow of contraband across the border is an important feature of maintaining national security, we do not believe New Delhi will engage in a major antidrug crackdown.

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Moreover, the corruption and drug issues are politically delicate for Gandhi. In our judgment, he is seeking ways to deprive state and national opposition

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## Near East and South Asia Brief

### Middle East-South Asia

#### Chernobyl Contamination Restricts Food Imports

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Concern over radiation from the nuclear accident at Chernobyl in April 1986 has led some Middle Eastern and South Asian countries to restrict imports of foodstuffs and other consumer goods from Europe. Many area countries rely heavily on imported food, and the restrictions, which vary from country to country, may result in some shortages. Evaporated milk imports have been especially hard hit by the new regulations. Egypt, Iraq, Iran, Bangladesh, Qatar, and Saudi Arabia have refused delivery of powdered milk and other milk products because of actual or suspected high levels of radiation. Iran's specifications are particularly hard to meet because they apparently require radiation levels in imported food that are lower than what was the norm before the Chernobyl accident. (S NF)

The discovery of high radiation in imports has sometimes resulted in conspiracy charges.

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B3  
In other area countries such as Bangladesh exporters have been accused of dumping contaminated goods in Third World markets.

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Relations between Middle Eastern and South Asian countries and some exporting countries have suffered, and some export companies have taken losses when customers have refused to accept contaminated food shipments. Bangladesh is trying to get Poland to pay not only for rejected imports but also for the cost of testing the imports for radiation. One US firm had its food exports rejected by Saudi Arabia because they had been transhipped through Europe. The United States subsequently has certified food products processed in the United States as free of radiation in response to these concerns. We believe the Middle Eastern and South Asian countries will turn increasingly to US suppliers of foodstuffs because of concerns over radiation in European goods.

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